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## The Railroad Week in Review 2/17/2001

Genesee & Wyoming (GNWR) operating results for FY2000 and 4Q00 are impressive. What we see is the emergence of a strong international player. The Main Event in 4Q00 was the consolidation of the Australia Southern Railroad (ASR) and the Australia Western Railroad (AWR) -- formerly known as Westrail Freight – into the new Australian Rail Group (ARG). On December 16, 2000, GNWR contributed ASR (formerly wholly owned) to ARG and now owns 50% of ARG. GWI is reporting its 50% interest in the net income of ARG using equity accounting and has therefore, as of December 16th, stopped consolidating ASR in its financial statements.

CFO Jack Hellman took the conference call through a dramatic reading of the financials and, for the quarter especially, a road map is in order. Total revenues came to $48.7 mm vs. $53.7 mm YTY. North American Railroad revenues were $38.4 mm, off 4.9% YTY from $53.7 mm in 4Q99 for the same reasons everybody else is down: higher fuel costs against a dip in carloads. Bright spots were more coal in Illinois, new gypsum board in Oregon, and intra-country intermodal in Mexico. Operating income was $4.4 mm, an 88.6% operating ratio, compared with $6.4 mm, an 84.2% operating ratio, in the 1999 quarter. Industrial switching revenues were $2.8 mm for the 2000 quarter compared with $2.6 mm for the 1999 quarter.

Australian 4Q00 revenues were $7.5 mm through 12/16 vs. $10.7 mm for the entire fourth quarter of 1999. Australian operating loss was $3.4 mm for the fourth quarter through December 16, 2000, including the $4.0 mm expense for the vesting of stock options triggered by the 50% sale of ASR. Australian operating income for the entire fourth quarter of 1999 was $1.8 mm. Equity income from GNWR's 50% ownership of the Australian Railroad Group was $0.3 mm for the fourth quarter of 2000, reflecting operating results for the final 15 days of December. ARG's total revenues over the period were $6.8 mm with operating income of $1.8 mm (all in US dollars). ARG's operating ratio for the 15-day period was 73.8%. Whew.

As if that wasn't enough, the quarter also saw completion of the transaction in Bolivia. Equity income was $0.2 mm, which represents 56 days of operating results from its new indirect 22.55% ownership of Empresa Ferroviaria Oriental, S.A. since November 6, 2000. And if they can do all that in 55 days, imagine what can be done in a year. But more on that in a moment

Pulling it all together, consolidated 4Q00 net income available to holders of the common stock was $4.0 mm, up17.6% YTY over last year's $3.4 mm. Diluted earnings per share came to $0.86 with average 4.7 mm diluted shares outstanding, reflecting the Company's $20 mm private placement of Redeemable Convertible Preferred Stock for the final 20 days of December 2000. Diluted earnings per share for the fourth quarter of 1999 were $0.78 on 4.4 mm average diluted shares outstanding.

For the full year, revenues rose 17.6% to $206 mm from $175.6 mm YTY and the net was up 11.2% to $13.9 mm from $12.5 mm. Operating ratios are still on the high side, 88.5 vs. 87.1 YTY, and the net margin remains in single digits at 7%. Based on what we heard today, this too should pass as the economies of scale take hold in Australia and the economy rights itself here.

Looking ahead, CEO Mort Fuller told the conference callers that the export-driven Western Australia economy has grown faster than the rest of Australia for the past decade. The ARG service area produces 18% of the world's alumina, 14% of its iron ore, and 14% of its nickel. Western Australia's 2000 grain harvest was the lowest in 5 years. A normal harvest in 2001 should benefit ARG by year-end.

Three conclusions emerge. First, the revenue outlook for North American operations are modest, though certain core operations, such as Illinois coal shipments, remain stable. Winter grain movements in Canada will continue into 1Q01 and an upstate NY salt mine is expected to start shipping salt to the tune of a $mm-plus annualized revenue midyear. Second, the ARG outlook is outstanding and the Alice Springs-Darwin construction phase ought to be good for another $mm for hauling construction materials beginning later in 2001. Third, GNWR sees a more favorable general environment for interest rates and fuel prices as we begin the first quarter of 2001. In sum, the planning has been precise and the execution flawless. Well done, all.

**C**anadian Pacific this week split itself five ways. To be sure, we had some advance warning it might be in the cards, though perhaps not quite so soon and so definitively. In Tuesday's announcement, CEO David O'Brien said he expected to see five new public companies emerge by fall, making the CP yet another "sum of the parts" story a la Kansas City Southern. Moreover, and especially as each of the parts enjoys excellence in its own right, further values could come to the fore should there be merger or acquisition partners along the way.

My back-of-the envelope value for the sum of the parts is $50 per share. Note that CP owns 86% of Pan Canadian so the Target Value is discounted accordingly. The "conglomerate discount" adds back corporate economies of scale to yield a pre-split value for CP.

| ***CP shares*** | ***317.9 m*** **Net Inc** | **FY2000 eps** | **Industry Multiple** | **Target Value** |
|---|---|---|---|---|
| **CPR** | $ 532 | $ 1.67 | 14 | $ 23.43 |
| **CP ships** | $ 234 | $ 0.74 | 5 | $ 3.68 |
| **PanCan** | $ 894 | $ 2.81 | 13 | $ 31.44 |
| **Fording** | $ 33 | $ 0.10 | 5 | $ 0.52 |
| **CP Hotels** | $ 156 | $ 0.49 | 8 | $ 3.93 |
| **Sum of Parts** | | | | $ 62.99 |
| **Congolomerate Disct** | | | | 20% |
| **Net Sum of the Parts** | | | | $ 50.40 |

Now to sanity check the rail valuation, the real reason we're all here anyway. Full year railroad revenues were $3,665 mm, $11.49 a share. Twice sales is a reasonable multiple for a good railroad -- $23 a share. Thus Tuesday's closing price of $37 and change means you can get the railroad for two bits and everybody else for half that.

For what it's worth, CP Rail racked up a 46% increase in net income YTY and lopped 4% off its share count. The rail operating ratio dropped to $76.9 from the low 90s and the net margin rose to 14.6 from 10.4. Debt/total cap is a respectable 39% and EBITDA covers interest 5.5 times. CP is the smallest of the Big Six class 1 roads, however numbers like these put it nicely in the lead group. Even, better, this dance has just begun.

Roy Blanchard